CHAPTER 11 MONOGRAPH

This monograph is to advise attorneys what the minimum requirements are when they represent a Chapter 11 debtor.

The goal of Chapter 11 is to rehabilitate the debtor. To reach this goal, the debtor's attorney must provide the Court, the United States Trustee, and the debtor's creditors with the necessary information for them to make decisions regarding the possibility of the debtor's rehabilitation.

COMMENCING A CASE

A voluntary Chapter 11 is commenced by filing a petition with the Bankruptcy Court. The petition should be accompanied by schedules of liabilities and assets, a statement of financial affairs, schedules of executory contracts, and schedules of the debtor's income and expenses, and if these documents are not filed with the petition they must be filed within 15 days thereof [Rule 1007(c)]. The debtor must file a mailing matrix and a statement disclosing the debtor's 20 largest unsecured creditors within 48 hours of filing a petition [Rule 1007(d)]. The debtor's attorney must file a Rule 2016(b) statement disclosing the amount, source, and balance due for any retainer to which the attorney and client agreed.

If the debtor is unable to meet any of the filing requirement deadlines, it may request that the time to file be extended. The debtor must make a motion to extend the time, and the Court may allow additional time. If the debtor needs more time than the first extension, a further extension can only be granted for cause.

An involuntary case against a debtor may be commenced under Section 303. An involuntary case can only be commenced if the debtor is equitably insolvent. The debtor has 20 days, after service of the summons, to contest the filing of an involuntary petition, and if the debtor fails to respond, an order for relief will be entered. If the debtor files opposition to the involuntary petition, the Court will hold a hearing to determine if the debtor is equitably insolvent. If the creditors commencing the involuntary case are unsuccessful, a judgment can be entered against them for costs and damages. In an involuntary case, schedules must be filed by the debtor within 15 days after the order for relief is entered [Rule 1007(a)(2)].

THE 341 MEETING

The 341 meeting is usually held within 20 to 40 days after the case is commenced. The Court sends out a 341 notice to all of the listed creditors, which gives the time and place of the meeting, and the procedure to file a proof of claim. Prior to the 341 Meeting, the United States Trustee will solicit the 20 largest unsecured creditors, who are not insiders, in an attempt to designate a creditors' committee.

The United States Trustee presides at the 341 meeting. The United States Trustee calls the meeting to order by stating the name and number of the case and requesting that all parties note their appearances for the record. The United States Trustee conducts the meeting by examining the debtor or its representative [Section 343].

The examination typically includes questions regarding: the nature of the business; the history of the business; the cause of the filing; the nature of the business assets; the current business; past losses and what steps that have been taken to reduce the losses; how the current operations will be financed; if a business plan or reorganization plan has been formulated; whether the debtor is negotiating with the creditors; the desirability of continuing the business; and the source of any money or property to be acquired by the debtor for purposes of consummating the plan and any consideration given. The debtor may also be examined regarding its acts, conduct or property and any other relevant matters. After the United States Trustee is finished asking questions, creditors are usually allowed to ask the debtor questions.

At the conclusion of the hearing, the United States Trustee may set an adjourned date for the 341 Meeting, for the purpose of having the debtor update the United States Trustee and the creditors

on the reorganizational progress.

THE CREDITOR'S COMMITTEE

The Code provides that the United States Trustee appoint a creditors' committee. The creditors' committee is usually made up of the seven largest creditors willing to serve, but the number of committee members can be smaller depending on the size of the case and the interest shown by creditors. The committee can only be altered after notice and a hearing for cause. More than one creditors' committee can be appointed if requested by a party-in-interest [Section 1102].

At a scheduled meeting of the committee, at which a majority is present, the committee may select and authorize the employment of attorneys, accountants, and other professionals to represent the committee. The committee should also elect a chairperson to preside over the committee. The first committee meeting usually takes place before the initial 341 meeting.

A creditors' committee may perform the following duties as specified by Section 1103(c):

1. Consult with the debtor or trustee regarding the administration of the case,
2. Investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business, the desirability of continuing the business, and any other matters relevant to the case and formulation of the plan,
3. Participate in the formulation of a plan and advise the creditors of the committees' recommendations,
4. Request the appointment of a trustee or examiner under Section 1104, and
5. Perform other services that are in the interest of the creditors.

The creditors' committee should examine the debtor's affairs and the cause of its insolvency. The committee will usually ask for financial statements and copies of the operating reports that have

been filed with the Court. These documents are helpful in determining the course of the reorganization process. The committee should report to the other creditors regarding the progress of the proceeding.

The committee should negotiate with the debtor concerning the terms of the proposed plan of reorganization and make recommendations to the creditors regarding the plan. The committee should determine if the plan is proposed in good faith, is in the best interest of the creditors, and is feasible.

This is not an exclusive list of the committees' activities, but merely an outline. The committees' goal should be to get the greatest return for the creditors, in light of the goal to reorganize the debtor. The committee should not force the debtor to propose a plan that is not feasible, nor should the committee recommend a plan that does not obtain the greatest possible return for the creditors. The dialogue between the debtor and the committee should allow a plan to be confirmed that is fair to both parties

PAYMENTS TO DEBTOR'S PRINCIPALS AND PROFESSIONALS

Attorneys are responsible for advising the debtor not to pay money or provide any other compensation to any accountant, attorney, or other professional after the Chapter 11 has been filed, unless a Court order to approve the employment and compensation has been obtained [Sections 327 & 328]. The debtor must submit an application to employ professionals to the United States Trustee, who will forward it to the Court. Once the Court has approved the employment, the professional can submit fee applications for interim allowances, but only once every 120 days [Sections 330 & 331].

Attorneys are also required to inform the debtor that no compensation can be paid to the debtor, insider or family member unless prior approval of the Court has been obtained. The debtor must file a motion with the Court seeking approval of insider compensation, which must be noticed to the United States Trustee, creditors and/or creditors' committee [Section 330].

MONTHLY OPERATING REPORT

Once a debtor is in Chapter 11, business does not continue as usual. The debtor becomes a trustee for the creditors and the debtor is required to act as a trustee. One of the most important functions of the debtor is to keep the Court, the United States Trustee, and the creditors informed of the status of the reorganization. The Court requires that the debtor file monthly operating reports with the Court and the United States Trustee.

The operating report provides information regarding the status of the debtor's current operations, including a monthly cash flow statement, and a statement of profit and loss on an accrual basis. The reports must be filed by the 15th day of each month for the preceding calendar month. The format for the monthly operating reports can be obtained from the United States Trustee's Office.

COMPLIANCE with COURT ORDERS, RULES and PROGRESS TOWARD CONFIRMATION of a PLAN

The Court and the United States Trustee monitor all Chapter 11 cases on a regular basis. If it is apparent that the debtor is not complying with the rules and orders of the Court or that no progress is being made toward filing a plan and confirmation, the United States Trustee or a party-in-interest may file a motion to have the debtor and its attorney appear and explain why the case should not be dismissed or converted to one under Chapter 7. The standard for conversion or dismissal is "for cause" and is contained in Section 1112. In the Rochester Division, this motion is covered by the Court's default policy and the debtor must submit any opposition to the motion three business days prior to the hearing. In addition, the debtor and its attorney must appear at the hearing to oppose a motion to dismiss.

THE AUTOMATIC STAY

Once a Chapter 11 case has been filed, all judicial and administrative actions against the debtor or its property are automatically stayed from both continuation and commencement. Practitioners should look at Section 362(a) & (b) to determine the scope of the automatic stay and Section 553 with respect to the scope of setoffs.

The automatic stay is one of the fundamental protections of the Bankruptcy Code. It provides the debtor with a breathing spell. The automatic stay halts collection efforts and foreclosure actions. It permits the debtor to attempt to formulate a repayment plan by relieving it of the pressure that forced it into filing for Bankruptcy.

Creditors are also protected by the automatic stay. Without the stay, creditors would continue their collection efforts against the debtor and its property. The creditors who acted the quickest would receive the most from the debtor. Bankruptcy provides an orderly liquidation procedure, where similarly situated creditors are treated equally. The automatic stay is designed to stay the enforcement of creditors' rights, but it does not affect the rights of creditors.

Section 362(b) contains the limitations of the automatic stay, but does not limit the injunctive power of the Bankruptcy Court to carry out the purposes of the Code. These limitations place the burden of obtaining an injunction on the debtor.

Sections 362(d), (e), (f), & (g) set forth the standards for relief from the automatic stay. Rule 4001 governs motions for relief from the automatic stay. The Court requires a cover sheet, copies of the lien or mortgage documents, proof of perfection, and a copy of the proposed order to be filed and served on the parties-in-interest (debtor, debtor's attorney, creditors' committee, creditors'

committee's attorney, and, if no creditors' committee the 20 largest unsecured creditors). The debtor must submit any opposition to lifting the automatic stay within three business days of the hearing date. The stay is automatically terminated if a hearing is not held, within 30 days, on a motion to lift the automatic stay.

If a trial on the issues is necessary, evidence that is persuasive to the Court includes: appraisals of the property; demonstration of the debtor's equity, or lack thereof, in the property; proof of potential substantial injury to the secured creditor from the loss, destruction, or severe diminution in the value of the property; evidence showing the debtor's need, or lack thereof, for the property to reorganize; and evidence showing the debtor's ability to successfully reorganize.

USE SALE OR LEASE OF PROPERTY

The debtor may enter into transactions, including the sale or lease of property of the estate, and may use property of the estate in the ordinary course of business without notice and a hearing unless the Court orders otherwise. But, the debtor cannot use, sell or lease property of the estate outside of the ordinary course of business without notice and a hearing [Section 363].

If the debtor wants to sell, use, or lease property outside of the ordinary course of business, it must make a motion to do so. The Second Circuit Court of Appeals has set forth the standards for this motion made in this District in *In re Lionel*, and practitioners making this motion should refer to this case.

If the debtor intends to use cash which a creditor has a security interest in, the debtor must obtain the creditor's consent to use the "cash collateral" or obtain Court approval of its use [Section 363(e)]. The debtor must file a motion and serve all creditors with security interests in the cash collateral, the United States Trustee, the creditors' committee or 20 largest unsecured creditors, if there is no committee. In the Rochester Division, this motion is covered by the Court's default procedure. If the debtor needs to be able to use the cash collateral sooner then the noticing rules allow, the debtor can file an order to show cause to shorten time and the Court will consider the motion on a case by case basis.

A hearing to use cash collateral can be either separate preliminary and final hearings, or the hearing can be condensed into one if the debtor provides at least 15 days notice to the parties-in-interest. If a preliminary hearing is held, the Court can only authorize the use of cash collateral if it is likely that the debtor will prevail at the final hearing. At either hearing the Court can condition the use of

cash collateral to provide adequate protection to the creditors. The debtor has the burden of proof.

EXECUTORY CONTRACTS AND UNEXPIRED LEASES

The pre-petition executory contracts and unexpired leases that the debtor entered into may be beneficial or burdensome to the estate. The Bankruptcy Code provides for both assumption and rejection of the executory contracts and unexpired leases of the debtor in Section 365. If an executory contract or unexpired lease is rejected, it is considered a "breach" and the estate is liable for the damages.

A debtor's attorney must pay particular attention to the executory contracts and unexpired leases because if the debtor does not assume, reject, or make a motion to extend the time to assume or reject within 60 days of the petition, the executory contract or unexpired lease is deemed rejected. If the debtor seeks to extend its time to assume or reject an executory contract or lease, the practitioner should refer to the Second Circuit Court of Appeals case, *In re Klein Sleep* for the standards which Courts in this Circuit must follow.

THE DISCLOSURE STATEMENT

The disclosure statement must contain "adequate information," which is defined by Section 1125(a)(1) as "information of a kind and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of the holders of claims or interests of the relevant class to make an informed judgment about the plan." As a guideline, the Court recommends that the debtor's disclosure statement contain the information listed below. This list is by no means exhaustive and the circumstances of an individual case may require deviation from the list or inclusion of more information than is required below.

The Plan

1. A brief summary of the plan.
2. A statement indicating that the full text of the plan filed with the Court is available for inspection at the Clerk's Office, along with all other papers filed in the case.

Business Operation

3. A description of the type of business operated by the debtor and the services it provides and/or the type of goods it sells.
4. The location and physical description of the debtor's place of business.
5. A brief narrative of the business.
6. A delineation of the problems that caused the business to falter.
7. A discussion of the business operations during the Chapter 11 period and what changes will be made from the debtor's pre-petition operations.

8. A statement as to why the debtor believes that the business will be more successful under the proposed plan than pre-petition.

9. A discussion of the competitive conditions faced and to be faced by the debtor.

10. A list of the pending litigation with which the debtor is involved.

11. A list of the existing executory contracts and unexpired leases that the debtor intends to assume or reject.

12. A list of contracts not made in the ordinary course of business, and/or entered into within two years of the filing.

13. If cash is to be received by the debtor, a list of its source, the commissions to be paid for its receipt, and disclosure of how the new cash will be used must be disclosed.

Officers, Directors, and Insiders

14. The names and addresses of the debtor's officers, directors, and insiders, if any.

15. The percentage of ownership of each officer, director, and insider at the time the petition was filed and any changes in the two years preceding the filing.

16. The current salaries and other compensation paid to officers, directors, and insiders and any compensation paid to these individuals in the two years preceding the filing.

17. Complete disclosure of any and all information regarding insiders.

Financial Information

18. A complete list of all property of the debtor, together with a description of the liens thereon.

19. Any report by a court-appointed examiner.

20. A balance sheet setting forth the actual values of any property as of the filing date.

21. Accrual profit and loss statements for the three years immediately preceding the filing.

22. A statement showing the debtor's receipts and disbursements during the Chapter 11.

23. A liquidation analysis, which includes the value of each of the debtor's properties and the amount to be received upon liquidation.

The extent of the disclosure required is in the discretion of the Court and depends on the type, size and complexity of the debtor's business.

The disclosure statement is normally required to be filed with the plan. After the disclosure statement is filed, the Court will schedule a hearing on 25 days notice to consider the disclosure statement and any objections or modifications made to the disclosure statement. In the Rochester Division, the Judge's Law Clerk will preliminary review the disclosure statement to determine if it contains adequate information. If it does, a hearing will be set, if not, the Law Clerk will notify the attorney of the changes that must be made prior to a hearing being set.

An objection to the disclosure statement may be filed up to the hearing date, unless the Court orders otherwise. The Court requires that objections be filed at least five business days prior to the hearing date.

THE PLAN AND SOLICITATION OF VOTES

If a trustee has been appointed in a Chapter 11 case, the Code permits any party to file a plan of reorganization. If a trustee has not been appointed and the debtor is in possession, the debtor has the exclusive right for 120 days to file a plan, unless the debtor makes the small business election, then the debtor only has 100 days to file a plan [1121(b), (c) & (e)].

If the debtor files a plan within the exclusivity period, the debtor has an additional 60 days of exclusivity to have the plan accepted. Both the exclusivity period and time to have the plan accepted can be enlarged or reduced by order of the Court [Section 1121(d)].

Section 1121 provides guidance on classification of claim and interests. Section 1123 sets forth the mandatory and permissive provisions of a plan. A claim or interest is impaired if its holder's legal, equitable or contractual rights are altered by the plan [Section 1124], and at least one impaired class must vote affirmatively for the plan. The debtor's attorney must understand and follow these provisions in order to present a confirmable plan. As long as a practitioner operates within the guidelines of these Code Sections, the plan can be as varied or ingenious as the debtor and its attorney want to make it.

After the Court approves the disclosure statement, the debtor may solicit votes on its plan of reorganization. The debtor's attorney is responsible for mailing the order approving the disclosure statement and confirmation hearing notice along with the approved disclosure statement, proposed plan, and ballot to all parties in interest. The plan must be accompanied by the court-approved disclosure statement, to render the entity soliciting the votes not liable for any violation of any applicable law, rule or regulation governing the offering, issuing, sale or purchase of securities.

VOTING ON THE PLAN

Section 1126(a) provides that holders of an allowed claim or interest may vote to accept or reject the plan within the time frames set by the Court [Rule 3017]. A plan is deemed accepted by a class of creditors if more than two-thirds in amount and one-half in number of the creditors vote to accept the plan [Section 1126(c)]. A class of equity holders are deemed to have accepted the plan if more than two-thirds in amount have voted to accept [Section 1126(d)]. A party-in-interest can object to the acceptance or rejection of a plan on the grounds that the acceptance or rejection was not solicited or procured in good faith or in accordance with the Code.

Solicitation of acceptances by a class is not required if the class is unimpaired by the plan, because those classes are deemed to have accepted the plan. Any class which does not receive payment or compensation is deemed to have rejected the plan.

Section 1127(a) allows a plan proponent to modify the plan at any time prior to confirmation without Court approval. After confirmation, but prior to substantial consummation, the plan proponent or the reorganized debtor can modify the plan, but Court approval after notice and a hearing is required. Any creditor who accepted or rejected the plan is deemed to have accepted or rejected the modified plan, unless that creditor affirmatively changes its vote.

CONFIRMATION HEARING

Section 1129 sets forth the eleven conditions that must be satisfied for a plan to be confirmed. Attorneys should read this section carefully when drafting a plan so that the conditions can be met. If all classes of creditors accept the plan and it is in the best interest of creditors (meaning that the creditors will receive as much through the plan as they would under a Chapter 7 liquidation), the plan may be confirmed. But, if all classes do not accept the plan, the plan can only be confirmed if at least one impaired class of creditors accepted the plan and the plan follows the absolute priority rule. In order to "cram down" a plan, each class must receive full payment prior to a junior class receiving any distribution. In addition, the plan must not discriminate unfairly and must be fair and equitable with respect to each class [Section 1129(b)].

If more than one plan is proposed, the Court can only confirm one plan, but must take into consideration the preferences of the parties in interest.

CONFIRMATION CHECKLIST

At the confirmation hearing the attorney is expected to have completed the "confirmation checklist." The Court's utilization of the checklist allows it to follow the attorney's presentation and ensure that the Section 1129 requirements are fulfilled. The form for the checklist may be obtained from the Clerk's Office.

The Court has determined that the confirmation checklist must be filed with the Court five business days prior to the confirmation hearing, but ballot totals can be filed at the time of the hearing and handed up to the Court.